88-446

Supreme Court, U.S.
FILED
SEP 14 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. _____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

CONTEMPORARY MISSION, INC.,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

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QUESTIONS PRESENTED

1. Whether the lower courts erred in revoking the tax-exempt status of a religious order, on the basis that the member-priests devoted 10 percent of their time to mail-order fundraising, and expended virtually all of the order's funds on fundraising and on support of the member-priests and their ministries.

2. Whether IRS and the lower courts violated the Religion Clauses of the First Amendment by applying different, and more rigorous, exemption standards to Petitioner as compared to religious orders covered by the group ruling letter of the National Catholic Welfare Conference.

PARTIES INVOLVED

The only parties are the Plaintiff, Contemporary Mission, Inc. and the Defendant, the United States of America.

TABLE OF CONTENTS

	Page
OPINIONS BELOW	1
JURISDICTION	1
STATUTES INVOLVED	1
STATEMENT	2
REASONS FOR GRANTING THE PETITION	8
CONCLUSION	17
APPENDIX A	1a
APPENDIX B	3a
APPENDIX C	4a
APPENDIX D	33a

TABLE OF AUTHORITIES

CASES:	Page
Alive Fellowship of Harmonious Living v. *Commissioner*, 47 T.C.M. 1134 (1984)	9,15
American Bar Endowment v. United States, 106 S.Ct. 2426 (1986)	11
Church of the Transfiguring Spirit v. *Commissioner*, 76 T.C. 1 (1981)	14
De La Salle Institute v. *United States*, 195 F. Supp. 891, 897 (N.D. Calif. 1961)	9,11
Estate of Charles J. Barry v. *Commissioner*, 34 T.C. 160 (1960)	9
Est. of Margaret E. Callaghan v. *Commissioner*, 34 T.C. 870 (1960)	9
Riley v. *National Federation of the Blind*, 1987 O.T. No. 87-328, decided June 29, 1988	11
St. Josephs Farms v. *Commissioner*, 85 T.C. 9 (1985)	10,12
Schaumberg v. *Citizens for a Better Environment*, 444 U.S. 620 (1980)	11
Secretary of State of Maryland v. *Joseph H. Munson Co.*, 467 U.S. 947 (1984)	11
Trinidad v. *Sagrada Orden*, 263 U.S. 578 (1924)	8,9,10,11
CONSTITUTION AND STATUTES:	
Internal Revenue Code of 1954 (26 U.S.C.):	
§ 501	1
§ 501(c)(3)	8,9,10,13
§ 7428	1
28 U.S.C. 1254( )(1)	1
Treas. Regulations on Income Tax (26 C.F.R.), Section 1.501	1,2

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

No. ___

CONTEMPORARY MISSION, INC.

Petitioner

v.

UNITED STATES OF AMERICA

Contemporary Mission, Inc. a Missouri not-for-profit corporation, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Federal Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App. A, *infra*) is not reported. The opinion of the Claims Court (App. C, *infra*) is also not reported.

JURISDICTION

The Judgment of the court of appeals (App. B, *infra*) was entered on June 21, 1988. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES INVOLVED

The relevant portions of Sections 501 and 7428 of the Internal Revenue Code of 1954 (26 U.S.C.), and of Section 1.501 of the Treasury Regulations on In-

come Tax (26 C.F.R.), are set out in a statutory appendix (App. D, *infra*).[1]

STATEMENT

Petitioner originated in the late 1960's among a priest and several seminarians who were members of the Society of Montfort Missionaries in St. Louis, Missouri. The group was doing inner city work and had differences with the Society, and in 1968 broke away to form Petitioner as a separate nonprofit corporation and religious order. (App. 5a-6a)[2] All of Petitioner's members took vows of poverty, chastity and obedience (Ex. 31.) In 1971, Petitioner's member-seminarians were ordained in Connecticut by a bishop of the Roman Catholic Church. (App. C, 10a.)

In Petitioner's 1970 application for a Section 501(c)(3) ruling, the Vice-Rector of the Missionary Society of the Holy Apostles stated that Petitioner was "affiliated" with the Society and, once the association was "finalized", would be included under its "banner" in the Official Catholic Directory. The St. Louis District Director issued a favorable ruling in 1970, stating that Petitioner was an "integral part of the operation of the Missionary Society of the Holy Apostles" and thus was covered by the group ruling issued by the IRS National Office to the National Catholic Welfare Conference. (App. C, 6a-7a.)

Subsequently, personality differences arose between some members of Petitioner and some members of

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[1] Section ____" references are to provisions of the Internal Revenue Code.

[2] "App. ____" references are to the Appendices to this Petition.

the Missionary Society of the Holy Apostles, and one of the Holy Apostle priests advised the IRS there was no relationship between the two organizations, except as to one involving a spiritual association. (App. C, 7a.)

Petitioner's stated purpose was to advance the principles set forth by Pope John XXIII in the encyclical "Pacem in Terris" through a communication and self-improvement apostolate. (App. C, 7a.) One phase of that apostolate involved the publication and distribution of religious songs and books to interest young people in the message of the Gospel, including records such as " 'Soulful' Songs for a Church in Change", and books such as "A New Catholic Catechism." (App. C, 8a-9a.)

From 1967-1977, all of the books and records produced by Petitioner were associated with and were incidental to this apostolate. (App. C, 27a.) Beginning in 1977, Petitioner also began to produce or sell (mainly through mail order) several books which were not primarily of a religious character, but which were primarily for fundraising purposes, such as "Secrets to the Short [Golf] Game" and "Garden Plan". Some of these books were not written by Petitioner's priests. (App. C, 13a-14a, 27a.)

As a group, Petitioner's priests in 1977 devoted approximately 10 percent of their working time to such direct mail activities. (App. C, 16a.) Father John O'Reilly was the coordinator of the mail order activities of Petitioner. During 1977, he spent 5 to 6 hours a day directing such activities. The other priests spent 2 hours or less per week on such activities. (App. C, 16a-17a.) Some of the work was performed by outside staff and firms. (App. C, 15a-16a.) Approximately 12

million mail solicitations were made in 1977, which generated net mail order profits of about $250,000. (App. C, 14a, 17a.)

Petitioner in 1977 had total cash receipts of $540,348, and current expenses of $448,900, leaving net income of $91,448. (App. C, 17a.) In addition, Petitioner had over $300,000 in mail order expenses incurred in 1977 which were paid in 1978. (A649-650.)[3] In 1977, Petitioner spent $200,574 for food, shelter, clothing, transportation, and other items for its members (App. C, 18a). That figure included all costs of maintaining a halfway house in Manhattan, (A956, 1081); travel and other expenses of the priests in carrying out their spiritual ministries; $42,877 in major capital expenditures on the residence (Ex. 29C)[4]; and the subsistence costs of two orphan teenagers of which Petitioner had legal custody (A765, A956, A958). Pursuant to their vows of poverty, Petitioner's member-priests received no salary or other compensation from Petitioner, but Petitioner pays all their expenses for activities which are carried out under their vows of obedience, including food, lodging, medical care, transportation, and other subsistence. (Pet. App. C, 18a.)

In 1972, Petitioner purchased a residence in Westport, Connecticut on Long Island Sound for $250,000. The down payment was $25,000 cash; the remainder was in notes for $100,000 (first mortgage, seller), $50,000 (second mortgage, Bank of Stratford), and $75,000 (second mortgage, seller). (App. C, 10a.) The

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[3] "A ____" references are to the record appendix filed in the court of appeals.

[4] "Ex." refers to exhibits admitted into evidence in the Claims Court.

seller later donated the $75,000 note to Petitioner by cancelling it. (A940-942.)

Petitioner furnished 3 automobiles and one motorcycle to provide transportation for the priests to use. (Pet App. C, 18a.) Two automobiles were Mercedes diesels purchased in 1976, which were still in use in 1985 with mileage of over 250,000 miles each. (A947.) A benefactor donated several lease payments for a third Mercedes, but Petitioner was unable to make the lease payments and had to turn back the car. (A946.)

Despite the quite detailed findings respecting the mail order activities summarized above, the Claims Court refused to make any findings as to how Petitioner's priests spent the other 90 percent of their time. The Court justified this failure on the basis that "the nature, existence, and performance of activities * * * which [Petitioner] claims entitle it to exemption were described by the priests in comprehensive and general terms. Some of * * * [Petitioner's] members recounted uncorroborated, often undated, anecdotes to describe the nature, existence and performances of the activities * * * [Petitioner] claims entitled it to exemption." (App. C, 20a-21a.)

In actuality, the priests' testimony as to their religious duties and activities was thorough, detailed and consistent. Father Berkery, who had been ordained since 1956, testified that each day he said daily Mass, did spiritual counseling; maintained records and helped with social welfare referrals at a lower New York City halfway house; did writing on spiritual books; read literature on current religious issues; led Petitioner's Mass association; and worked to bring

destitute children into the United States. (A1013-1016.)

Father Cassidy performed spiritual counseling; prepared audio tapes containing spiritual counseling and meditations; counseled runaways and teenagers at a New York City halfway house for teenagers; and gave retreats. (A1082-1087-1089, 1119.)

Father Coyne worked in New York City conducting funeral services; counseled teenage runaways at the Petitioner's lower-Manhattan halfway house; provided spiritual counseling for adults; and helped run Petitioner's Mass association. (A1137-1141.)

Father Middendorf resided 24 hours a day and operated Faith Center, which was Petitioner's halfway house for runaway teenagers in lower Manhattan. (A1141.)

Father O'Reilly was the bursar of the community, and worked almost full-time directing all of Petitioner's direct mail activities. (A561.) These included the fundraising publications and records described above, and also numerous religious books and records which constituted part of Petitioner's religious ministry. (A561, 1025.) He also conducted some funerals. (A563.)

Petitioner's funds were expended under the general authority and supervision of Father Berkery, Petitioner's leader. Responsibility for financial affairs, expenditures, the mail order operation, provision of supplies, and maintenance of the parsonage, rested with Father O'Reilly as bursar. Under the general supervision of either Father Berkery or Father O'Reilly, all members of Petitioner had authority to

write checks, and all did so from time to time. (App. C, 19a.)

Petitioner did not maintain written petty cash records for cash expenditures of its member-priests. Instead, each priest received oral authorization from Fr. Berkery or Fr. O'Reilly, and then was either provided cash or was told to write a check to cover the estimated amount of the expenditure. (App. C, 20a.)

On audit, and at trial, the Internal Revenue Service attempted to require each priest to explain and substantiate the expenditure of every check that was written in the years in issue. For example, the Government refused to accept testimony that checks to grocery stores used by Petitioner were for food, or that certain checks for cash were for money to pay direct mail companies for postage.[5]

Petitioner's witnesses were able to give general explanations for virtually all of the checks—for example, that challenged $40 checks for cash were for Fr. Middendorf's two-day trips to New York City to do his apostolic work of conducting funerals and assisting at halfway houses. (A738, 740, 925-926.) The Claims Court held such evidence insufficient because Petitioner's member-priests could not identify the purpose and payee of every dollar of every check. (App. C, 20a.)

One of Petitioner's priests joined the Eastern Rite of the Roman Catholic Church in 1974 and was allowed to marry. (A556, 960.) His wife served as

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[5] See pages 12-13 of the Government's Brief as Appellee in the Federal Circuit, challenging the priests' testimony recorded at A719, 728-729, 739, 754, and 928-934.

housekeeper at Petitioner's headquarters, and also assisted with Petitioner's mail order work. (A957-959.) Despite the fact that she received no wages or salary for her housekeeping, the Government challenged the amounts which Petitioner spent for her subsistence.[6]

REASONS FOR GRANTING THE PETITION

A. The Opinions Below Conflict with Decisions of this Court.

Petitioner was organized by former members of a Roman Catholic religious order, who broke away to form Petitioner as a separate religious order. Petitioner's member-priests took vows of poverty, chastity and obedience, conducted a religious ministry consisting of administering the sacraments, spiritual counseling, and operated a lower Manhattan half-way house. Although Petitioner's priests received no salary for their work and received their subsistence from Petitioner like members of Roman Catholic religious orders, the lower courts erroneously found that such subsistence required denial of tax-exempt status because it constituted private benefit and inurement prohibited by Section 501(c)(3).[7]

The decisions of the lower courts are in conflict with the opinion of this Court in *Trinidad* v. *Sagrada Orden*, 263 U.S. 578 (1924), and the long line of cases and administrative authorities which have held that

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[6] See Government's Br. as Appellee in the Federal Circuit, p. 9.

[7] Section 501(c)(3) requires that a tax-exempt organization be operated exclusively for public rather than private purposes, and that its net earnings not inure to the benefit of private individuals.

religious orders qualify for tax-exemption under Section 501(c)(3). The *Sagrada Orden* case involved the tax-exempt status of the Catholic Dominican Order[8] in the then American Philippine Islands. The priests of that Order carried on the activities of saying Masses, administering the sacraments, private prayer and study, operating schools, renting real property, and selling bread, wine and chocolate to the general public. The Court rejected the Government's contention that the rental and sales activities, which provided funds for the subsistence of the member priests, precluded the Order from satisfying the "exclusively" religious requirement of the statute.

Over the years, the *Sagrada Orden* opinion has been consistently interpreted to allow tax-exempt Catholic and other religious orders to use their revenues—whether from religious ministries or commercial activities—to provide food, lodging, transportation and other subsistence to members who otherwise receive no wages or salary. E.g., *De La Salle Institute* v. *United States,* 195 F. Supp. 891, 897 (N.D. Calif. 1961) (Christian Brothers Order exempt under §501(c)(3), although winery profits subject to unrelated business taxes); *Alive Fellowship of Harmonious Living* v. *Commissioner,* 47 T.C.M. 1134 (1984) (religious order composed of married couples providing "Polarity" therapies and retreats to public is tax-exempt); *Est. of Margaret E. Callaghan* v. *Commissioner,* 33 T.C. 870 (1960) (Carmelite religious order tax exempt under §501(c)(3) predecessor); *Estate of Charles J. Barry* v. *Commissioner,* 34 T.C. 160 (1960)

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[8] The "Holy Order of Preachers"—*viz., Sagrada Orden de Predicadores.*

(Jesuit religious order tax-exempt under estate tax analogue of Section 501(c)(3)); *St. Josephs Farms* v. *Commissioner,* 85 T.C. 9 (1985) (Catholic religious order operating full-time farm and selling produce to public is tax-exempt).

The lower courts totally ignored *Sagrada Orden* and this line of cases, and required the priests of the acknowledged religious order here to satisfy requirements which are different, and far more severe, than in prior cases. The courts erroneously rejected the priests' hour-by-hour descriptions of their daily schedules of prayer, meditation, spiritual reading, pastoral work, and mail order fundraising as too "comprehensive and general" and "encompass[ing] virtually all activities [that the] priests undertook during their waking hours. (App. C, 20a-21a.) But the very nature of a religious order is a group in which prayer, study, ministry and fundraising activities occupy virtually all of the members' time and energy. No prior case has required priests, nuns, or other members of religious orders to document all their time, much less to demonstrate that 8 hours a day were spent on ministering to the public. In the instant case it is clear from the opinion below that the courts improperly treated time devoted to saying daily Mass, prayer, and study as a personal activity rather than a part of Petitioner's religious activities.

The lower courts also erred in holding that a prohibited private benefit existed because "few expenditures were made which were not either part of the mail order program or for support of [petitioner's] * * * members [and] this support of the priests and their families manifests a nonexempt purpose." (App. C, 30a.) But the same situation existed in the *Sagrada*

Orden case, and all other cases involving tax-exempt religious orders; virtually *all* expenditures in those cases were used for support of the members and to pay for fundraising expenses. In a religious order of priests, expenditures for food, lodging, transportation, and other subsistence are the necessary expenditures for carrying out the order's ministries.

The lower courts further erred in revoking exempt status on the ground that 10 percent of the priests' time was spent in the mail order fundraising activity. This Court has frequently recognized the need for tax-exempt charities to devote substantial time and effort to fundraising, and has rejected governmental efforts to place arbitrary limits thereon. *Riley* v. *National Federation of the Blind,* 1987 O.T. No. 87-328, decided June 29, 1988; *Schaumberg* v. *Citizens for a Better Environment,* 444 U.S. 620 (1980); *Secretary of State of Maryland* v. *Joseph H. Munson Co.,* 467 U.s. 947 (1984).

In the past, the Government has generally recognized the necessity of fundraising activities for tax-exempt organizations, and has merely taxed them as unrelated business even where they constituted large proportions of the organization's activities. For example, in *American Bar Endowment* v. *United States,* 106 S.Ct. 2426 (1986), reversing 4 Cl. Ct. 404 (1984), a charitable organization received virtually all its income from direct mail sales of insurance—$12.8 million in gross premiums and $5.1 million in premium rebates, less $1.5 million expenses. This Court held that this activity was an unrelated business, but the tax-exempt status of the organization was left undisturbed because all net profits funded charitable activities. Similarly, in *De La Salle Institute* v. *United*

States, supra, the tax-exempt status of the Christian Brothers religious order was upheld even though the order operated the then largest winery and brandy distillery in California, with net profits (in 1956 dollars) of over $3 million a year from that unrelated business. In *St. Joseph Farms* v. *Commissioner,* 85 T.C. 9 (1985), the Tax Court recognized the tax-exempt status of a corporation operated by 12 members, even though it grossed $450,000-$650,000 per year from sales of farm products to the public, with average yearly net profits of $66,000, and the members devoted the majority of their time to the farm.[9] Indeed, most monasteries could not meet the 10 percent test applied by the courts below, since their members generally spend 6-8 hours per day in fundraising—such as the production of raw or processed food for sale to the general public.[10]

The lower courts also erred by requiring Petitioner to document or explain from memory the precise purpose, use, and recipient of every dollar of every check cashed by a priest. The Government conceded[11], and

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[9] The Tax Court held that the farm was a fundraising activity and not substantially related to the religious purpose of the religious order. However, the Tax Court did not apply the unrelated business tax because the farm was operated almost entirely by the members of the order, and was thus deemed to satisfy the exclusion for activities conducted by uncompensated personnel.

[10] The Christian Brothers winery and the Trappist Monks' Monastery Bread are the most widely known examples. See the descriptions of the tax-exempt Catholic religious orders in I.R.S. Private Letter Rulings 7838028, 7838029, 7838030, 7838032, 7838034, 7838035, and 7838036. A copy of P.L.R. 7838028 is reproduced at App. D, 33a-51a.

[11] Brief of Government in Claims Court, p. 17.

the Claims Court found (App. C, 30a), that "Few expenditures were made which were not either part of the mail order program or for support of * * * [Petitioner's] members." The Claims Court also found that Petitioner's superior or its bursar "exercised general authority and supervision over all expenditures of funds and writing of checks." The lower courts' conclusion that it was improper to spend Petitioner's funds for the priests' subsistence, and their requirement that Petitioner must prove and substantiate that not one dollar was spent for the priests' subsistence, is in fundamental conflict with *Sagrada Orden.*

The Government erroneously contended that *every* expenditure must be substantiated and shown to be for a ministry activity. For example, the Government contended:

> to testify that a check payable to "Patsy's was for a restaurant frequented by one of plaintiff's members is not to establish for what the expenditure was actually made. Was this a lunch at which Mission business was discussed? Or simply a meal in the course of some of their activity? If the latter, in the course of just *what* activity? Businessmen must keep elaborate records to substantiate mere deductions for such expenditures. Plaintiff seeks to base complete exemption from tax upon less.[12]

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[12] This position erroneously attempts to read Code Section 267 substantiation requirements, which are applicable to *business* deductions, into Section 501(c)(3). There is no authority for such position. It would make no sense, since tax-exempt religious

Petitioner's priests testified generally as to the purpose of each check—e.g., that a $40 check for cash was for gas, tolls, meals, and other expenses for a two-day ministry in New York City. However, they were not required to have records or recollection of every dollar spent.[13]

Finally, the lower courts mistakenly held that the benefits received by Petitioner's member-priests did not constitute reasonable compensation. (App. C, 31a.) The courts made no findings, however, as to the amounts of compensation received, or why such amounts were unreasonable. The Government erroneously contended that the $200,573.63 spent on 1977 operations amounts to the unreasonable total of $40,000 per member, but this amount included all expenses of the halfway house, all travel and other expenses of the religious ministries, capital expenditures for the parsonage, and the expenses of caring for the two orphans. A subsequent I.R.S. audit of Petitioner for 1980-1983 showed that each member received only $9000-$9600 per year in benefits. (A302.) The Claims Court erroneously held that this audit was irrelevant and refused to admit the audit report into evidence.[14]

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orders do not have deductions, and must pay all their members' reasonable personal expenses.

[13] The cases relied on by the lower court do not require substantiation by religious orders. *Basic Bible Church* v. *Commissioner*, 74 T.C. 846 (1980), involved a branch of a notorious national tax avoidance scheme, and the Tax Court held (*id.* at 857) that the members' vow of poverty was not unconditional or genuine. *Church of The Transfiguring Spirit* v. *Commissioner*, 76 T.C. 1 (1981), did not involve a religious order whose members took vows of poverty.

[14] The Government also appeared to argue that the $250,000

B. Denial of Exempt Status to Petitioner Violates the Religion Clauses of the First Amendment.

The Free Exercise Clause of the First Amendment prohibits the Government from discriminating against a religion or religious organization. The Establishment Clause prohibits Government from preferring one religious organization over another.

In the instant case, the courts have unconstitutionally applied to Petitioner requirements and standards which are distinctly different and more rigorous than those applied to religious orders of the Roman Catholic Church, and similar religious orders of other religions. The thrust of the Government' position here is that Petitioner's member-priests spent too much time and money on their direct mail activity, and that they did not adequately substantiate their religious activities. For this reason, the Internal Revenue Service revoked Petitioner's exemption for the year 1977.

At the same time that the Internal Revenue Service was taking this action, however, it was considering the tax-exempt status and unrelated business classification of several Roman Catholic religious orders. In several rulings issued in 1978, the Service's Na-

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parsonage, the three Mercedes diesel automobiles, and clothing purchased for the priest's wife-housekeeper showed inurement. The lower courts did not adopt that contention. A $250,000 parsonage in high-cost Connecticut for housing six adults, four children, and two foster children, and for offices, chapel, and retreat center for visiting priests, is hardly lavish or extravagant. As explained above, only two Mercedes diesels were retained, and they each had very high mileage. The government complains about a $200 clothing charge for the priest's wife—another indication that it erroneously objects to *any expenditure* for this purpose, contrary to cases such as *Alive Fellowship of Harmonious Living* v. *Commissioner, supra.*

tional Office ruled that numerous business and fundraising activities conducted by such religious orders would not constitute unrelated businesses for years prior to 1978, and would constitute unrelated businesses for years beginning 1978.[15] Moreover, the rulings implicitly held that such activities would not affect tax-exempt status of the Roman Catholic orders for any time period. The activities approved were carried on an average of 6 hours a day by the religious orders' members, and included production and direct and/or mail order sales of the following items to the general public: miscellaneous arts, crafts and gifts; bread; pottery; candles; polished stones and rocks; agricultural products such as grapes and peaches; timber; concrete blocks; unprocessed grain and hay; cheese and fruitcakes; religious arts and crafts; beefcattle; vegetables and honey; prunes and walnuts; cattle and sheep; hay and Christmas trees; caramel candy; meat; altar breads and breads and altar vestments; altar furnishings and vestments; and firewood.[16]

Thus, for the very year when I.R.S. was denying exempt status to the Petitioner's religious order for devoting an average of 2 hours a day to mail order sales, it was allowing members of Roman Catholic religious orders to devote 6 hours a day to like activities. Moreover, these rulings approved the exempt status of Roman Catholic religious orders even though all of the time of the monks not devoted to such fundraising activities was devoted to "worship * * *

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[15] See footnote 9, *supra.*

[16] *Id.*

and private prayer or reading".[17] Yet here, the Government and the lower courts refused to consider the priests' prayer and worship as part of their exempt activities, and required detailed documents and specific descriptions of their religious ministries. Indeed, the priests here were even asked the identities of their penitents and counselees, information which they considered privileged and properly refused to divulge. (A630.) It is clear that the requirements imposed upon Petitioner were much stricter than those applied to the Roman Catholic religious orders, and discriminated against and denigrated the worship and prayer activities of Petitioner's priests.

The Government and the lower courts make much of the fact that Petitioner was not listed in the "Directory"—the group exemption ruling list—of the National Catholic Welfare Conference, which is the Official United States Catholic agency. (Pet. App. C, 23a.) But that fact should have no legal significance or authority, and demonstrates the unconstitutional preference which the lower courts and the Government granted to religious orders affiliated with the National Catholic Welfare Conference.

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[17] *Id.*

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted

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APPENDIX

APPENDIX A

Note: This opinion has not been prepared for publication in a printed volume because it does not add significantly to the body of law and is not of widespread legal interest. It is a public record. It is not citable as precedent. The decision will appear in tables published periodically.

United States Court of Appeals for

Federal Circuit

87-1521

CONTEMPORARY MISSION, INC.

Plaintiff-Appellant,

v.

THE UNITED STATES,

Defendant-Appellee.

DECIDED: June 21, 1988

Before SMITH, NIES, and MICHEL, Circuit Judges. PER CURIAM.

Contemporary Mission, Inc. (Mission), appeals the judgment of the United States Claims Court in Contemporary Mission, Inc. v. United States, No. 557-79T (Cl. Ct. filed June 17, 1987) (Harkins, S.J.). The Claims Court held that Mission failed to prove it was operated exclusively for tax-exempt purposes, and that there was no inurement to the benefit of its members. That court concluded that Mission did not qualify as a tax-exempt organization under section 501(c)(3) of the Internal Revenue Code of 1954, as amended. On the basis of the opinion of the trial judge, the Claims Court's decision is affirmed.

APPENDIX B

United States Court of Appeals for the Federal Circuit

87-1521

CONTEMPORARY MISSION, INC.

Plaintiff-Appellant,

v.

THE UNITED STATES,

Defendant-Appellee.

JUDGEMENT

ON APPEAL from the United States Claims Court. This cause having been heard and considered, it is ORDERED and ADJUDGED: AFFIRMED.

DATED June 21, 1988

ISSUED AS A MANDATE: April 18, 1988

Costs: Against; Appellant

Printing.....$188.52

Total.....$188.52

ENTERED BY ORDER OF THE COURT

Francis X. Gindhart, Clerk

APPENDIX C

In the United States Claims Court

No. 557-79T

(Filed: June 17, 1987)

CONTEMPORARY MISSION, INC.)
)
v.)
)
THE UNITED STATES)
)

ORDER

In its petition (now complaint), filed December 10, 1979, in the United States Court of Claims, plaintiff, Contemporary Mission, Inc., sought a declaratory judgment pursuant to Section 7428(a)(1)(A) of the Internal Revenue Code of 1954, as amended (IRC). The complaint challenged the September 11, 1979, determination by the Boston District Director of the Internal Revenue Service (IRS) as to the continuing

qualification of Contemporary Mission, Inc. for exemption under IRC § 501(C)(3).

The case was suspended from April 16, 1982, to May 14, 1984, to permit settlement negotiations with the IRS. Trial was held November 18-21, 1985, and posttrial briefing was completed January 22, 1987. For the following reasons the September 11, 1979, revocation of plaintiff's exempt status was in accord with the IRC and the IRS regulations, and defendant is entitled to prevail.

The facts are as follows:

1. Plaintiff was incorporated in 1968 as a Missouri not-for-profit corporation. Plaintiff had its origins in inner city work done by a group of then seminary students (and one Montfort priest who led the group) at the Montfort Fathers seminary in St. Louis. As a result

of differences with some of the Montfort Fathers, the group broke away.

2. (a) On February 25, 1970, plaintiff applied for exemption from federal income tax under Section 501(c)(3) of the Internal Revenue Code of 1954 by filing a Form 1023 with the District Director of the IRS in St. Louis.

(b) In support of plaintiff's application, the Reverend I.N. Raney, Vice-Rector of the Missionary Society of the Holy Apostles, stated that plaintiff was "affiliated" with the Society and, once the association was "finalized", would be included under its "banner" in the Official Catholic Directory. In his determination letter, the St. Louis District Director stated that inasmuch as plaintiff was an "integral part of the operation of the Missionary

Society of the Holy Apostles" it came within the group ruling issued by the IRS National Office to the National Catholic Welfare Conference.

(c) Subsequent to the issuance of the District Director's determination letter, personality differences arose between some members of Contemporary Mission, Inc. and some members of the Missionary Society of the Holy Apostles, and one of the Holy Apostle priests advised the IRS there was no relationship between the two organizations, except as to one involving a spiritual association.

3. (a) Plaintiff's members contend Contemporary Mission, Inc. was founded in order to advance the principles set forth by Pope John XXIII in the 1963 encyclical: Pacem in Terris. Plaintiff's members started a "communication and self-

improvement apostolate" in or about 1967. One phase of the communication apostolate involved the publication of songs and books written to interest young people in the message of the Christian Gospel.

(b) During the period 1967-77, the following record albums were produced by plaintiff's members and were available for distribution by plaintiff.

Everything's Just Fine..Or
Is It?
Disco Teach
There'll Come A Day
Let's Get Together
Becoming One
"Soulful" Sounds for a Church in
Change
Prayers for a Noonday Church
Virgin, a Rock Opera.

(c) During the period 1967-77, the following books were published by

plaintiff's members and were available for distribution by plaintiff: A New Catholic Catechism, Copyright 1970; Is Religious Life Possible?, Copyright 1969; Restructuring Religious Life, Copyright 1967; Glimpses from the Ghetto, Copyright 1970; Soulful Sounds, Copyright 1968; Becoming One, Copyright 1971; Voices of Change, Copyright 1970; Dialogues in Self-Fulfillment, Copyright 1967.

(d) The following books written by Father Berkery were published and available for distribution after 1977: The Secret, Copyright 1978; The Edgar Cayce Guide to Self-Healing, Copyright 1979; Biofeedback Without Machines: A Strategy for Living, Copyright 1980.

(e) Plaintiff marketed its first album "There'll Come A Day" through direct mailing in 1967.

4. (a) The priests of Contemporary Mission, Inc. are ordained priests of the Roman Catholic Church and are authorized to perform sacerdotal functions and administer the sacraments. Ordination ceremonies of plaintiff's members (other than Father Berkery) were conducted by a foreign bishop at the Missionaries' facility in Cromwell, Connecticut, in May 1971.

(b) In 1972, plaintiff purchased a residence at 285 Saugatuck Avenue, in Westport on Long Island Sound, for $250,000. The down payment was $25,000 cash; the remainder was in notes for $100,000 (first mortgage, seller), $50,000 (second mortgage, Bank of Stratford), and $75,000 (second mortgage, seller).

(c) Father Patrick Berkery, Father John O'Reilly, Father John Coyne, Father Robert Cassidy, and

Father Donald Middendorf constituted the membership of plaintiff in 1977, and were members at time of trial.

5. (a) In a ruling letter issued September 11, 1979, the Boston District Director of the IRS revoked the determination letter previously issued to plaintiff by the St. Louis District Director. The revocation was based on two separate grounds: first, that plaintiff was not operated exclusively for exempt purposes, and second, that plaintiff's net profits inured to the benefit of private individuals. The revocation was retroactive to January 1, 1977.

(b) The Boston District Director found that plaintiff was not exempt from Federal income tax under the group ruling issued to the U.S. Catholic Conference. The letter concluded that an examination of the

materials distributed by plaintiff in 1977 made it evident that the "communications and self-improvement apostolate" serves exempt religious purposes no more than would a random distribution of "self-improvement" selections available at an ordinary bookstore, and that the size of the mail order operation indicated that plaintiff's primary purpose was to carry on an unrelated trade or business. Plaintiff's distribution, promotion, and marketing techniques were found to be indistinguishable from those of an ordinary commercial enterprise.

(c) With respect to inurement, the letter noted that the nature of the checks drawn on plaintiff's accounts is evidence that members were free to make personal use of plaintiff's earnings, and that the character of the payments indicates

they are a benefit from plaintiff's net earnings rather than part of an established compensatory scheme.

6. (a) During 1977, plaintiff's direct mail activities included direct-mail solicitations to sell, and the actual selling of, the following items: Atkins, [a diet book], 3,048 units sold, gross sales of $29,517.42; Drug Program, 74 units sold, gross sales of $682.30; Jesus Album [a record], 142 units sold, gross sales of $1,568.90; Guaranteed Golf Lesson, 221 units sold, gross sales of $2,367.85; Secrets to the Short Game [golf], 5,376 units sold, gross sales of $56,829.29; Wrist Trainer [a golf exercise device], 3,039 units sold, gross sales of $94,228.60; Living Cross, 242 units sold, gross sales of $2,558.31; Garden Plan, 234 units sold, gross sales of $2,467.102; Life Without

Pain, 2,533 units sold, gross sales of $26,672.86; The Edgar Cayce Handbook for Health Through Drugless Therapy, 41,057 units sold, gross sales of $408,517.15; Guaranteed Tax Plan [1976 Ed.], 40,901 units sold, gross sales of $437,079.80; Guaranteed Tax Plan [1977 Ed.], 37,039 units sold, gross sales of $400,021.20; 103,906 total units sold and total gross sales of $1,462,510.82.

(b) In order to make these sales, plaintiff mailed out approximately 12 million solicitations in 1977. Over 9 million of the solicitations were for the tax books.

7. (a) Plaintiff used several different mailing lists for solicitations of its mail order products. In addition to books and publications written by its members,

plaintiff obtained mail order products from other makers or publishers and then marketed them.

(b) Plaintiff's direct mail activities involved obtaining rights to products, preparing solicitation materials, renting mailing lists, hiring printers for solicitation materials and envelopes, hiring lettershops and fulfillment houses to do the mailing, and dealing with the United States Postal Service.

(c) To reduce its members' direct participation in the mail order program, plaintiff hired outside help to work at the Contemporary Mission residence on the direct mail activities.

(d) Plaintiff sent its direct mail order cards to a data processing company which entered the orders into a computer, producing shipping labels to be sent to a fulfillment house, as

well as sales reports for plaintiff's use.

8. (a) Father John O'Reilly was the coordinator of the mail order activities of plaintiff. During 1977, Father O'Reilly was the coordinator of the mail order activities of plaintiff. During 1977, Father O'Reilly spent 5 to 6 hours a day directing the mail order activities of plaintiff. This activity exceeded the time spent on any other Mission related activity during the remainder of his waking hours.

(b) Father Cassidy spent a few hours each week working on plaintiff's mail order activities.

(c) Father Coyne spent 2 to 3 hours each week working on plaintiff's mail order activities.

(d) In 1977, Father Berkery spent very few hours per week to

direct mail activities. As a group, plaintiff's priests in 1977 devoted approximately 10 percent of their working time to direct mail activities.

9. For 1977, plaintiff's records show income and expenses as follows:

Income:	
Net profit from mail order activities	$250,347.98
Receipts from Contemporary Mission, Inc. v. Famous Music Co., et al.	$290,000.00
	$540,347.98
Expenses:	
Losses from investments	$240,041.70
Operations	200,573.63
Contributions	8,285.00
	$448,900.33
Excess of receipts over disbursements	$ 91,447.65

10. (a) In 1977, plaintiff generated cash profits of at least

$250,347.98 from its mail order activities.

(b) Plaintiff utilized at least $200,573.63 of its cash income to support its members and other individuals. Plaintiff provided this support to its members and other individuals by supplying food, shelter, clothing, transportation, and other items.

(c) Shelter was provided in a 19-room house located on Long Island Sound in Westport, Connecticut.

(d) Transportation was provided by making automobiles and a motorcycle available for use.

(e) Cash was provided to plaintiff's members for their general expenses. Plaintiff did not keep any petty cash records during 1977.

11. Proceeds of the direct mail operation were deposited in checking accounts and, through transfers,

drawn upon by plaintiff's members.

12. (a) The record indicates that plaintiff received few contributions in 1977. The funds received through the direct mail marketing operation were plaintiff's only significant continuing source of income in 1977.

(b) Plaintiff's funds were expended under the general authority and supervision of Father Berkery, the group's leader. Responsibility for financial affairs and actual expenditures, the mail order operation, provisions of supplies and utilities for the house and the like, rested with Father O'Reilly as bursar.

(c) Under the general supervision of either Father Berkery or Father O'Reilly, all members of plaintiff had authority to write checks, and all did so from time to time.

13. (a) In many instances, Father Berkery was unable to explain why particular checks had been written or the particular expenditures they were for, or to identify the payee of checks signed by him, or to indicate the property purchases or services compensated by particular checks.

(b) In many instances, Father Cassidy's explanation as to why particular expenditures had been made was incomplete. The payee of some of the checks signed by him could not be identified.

(c) Father O'Reilly was unable to explain the particular purposes for some of the checks signed by Father Middendorf. Plaintiff failed to produce any documents to corroborate Father O'Reilly's explanations of why particular checks had been written.

14. (a) The nature, existence, and

performance of activities plaintiff claims entitle it to exemption were described by the priests in comprehensive and general terms. Some of plaintiff's members recounted uncorroborated, often undated, anecdotes to describe the nature, existence and performance of the activities plaintiff claims entitle it to exemption. The descriptions of the communications and self-improvement apostolate encompassed virtually all activities plaintiff's priests undertook during their waking hours.

(b) Plaintiff did not keep records of most of the religious and charitable activities it performed in its communication and self-improvement apostolate. Father O'Reilly testified that the selling of a tax book through plaintiff's direct mail operation was part of

plaintiff's communication and self-help apostolate.

(c) Plaintiff in its stock investment program utilized a stock quotation machine from GTE Information Services. The relationship of this activity to the communication apostolate was not explained.

(d) Father O'Reilly testified that plaintiff's purchase of clothes for Father O'Reilly's wife was a charitable work. He also testified that clothing purchases for his wife were equivalent to salary for cooking and housecleaning work she performed. Father Berkery testified that purchases of clothing for Father O'Reilly's wife and children contributed to the communications apostolate of plaintiff.

15. Plaintiff contends it is a pious society of the Roman Catholic Church.

Plaintiff has never been listed in the Official Catholic Directory under The Missionary Society of the Holy Apostles. Plaintiff is not included among organizations covered by the ruling issues to the National Catholic Welfare Conference. Plaintiff did not produce at trial any documents to support its contention that it is a pious society of the Roman Catholic Church.

DISPOSITION

Section 7248 of the Internal Revenue Code of 1954, as amended provides a remedy for resolving disputes concerning the continuing qualification of an organization as an exempt organization described in Section 501(c)(3) of the Code. In a case that involves a revocation of a qualification or classification, the burden is on the petitioning organization to demonstrate that the

Commissioner's action was in error, and that the organization is exempt. John Marshall Law School v. United States, 48 AFTR 2d 81-5340 (Ct. Cl. Tr. J. Op., June 24, 1981), adopted Sept. 29, 1981, 228 Ct. Cl. 902; Prince Edward School Foundation v. Commissioner, 478 F. Supp. 107, 110-11 (D.D.C. 1979).

Section 501(c)(3) provides an exemption from the Federal income tax for a corporation that can show that it is "operated exclusively" for exempt purposes, and that no part of its net earnings "inures to the benefit of any private shareholder or individual." The IRS regulations permit no more than an insubstantial part of the organization's activities to further a nonexempt purpose. 26 C.F.R. § 1.501(c)(3)-1(c)(1) (1986). Where the facts show operations that established the existence of a

substantial nonexempt purpose, it is immaterial that the organization also has exempt purposes or activities. Better Business Bureau v. United States, 326 U.S. 279, 283 (1945).

Plaintiff's priests testified at length about the definition of a church, and emphasized their status as priests of a particular church. Plaintiff relies on the definition of a church in the IRS regulations. 26 C.F.R. § 1.511-2(a)(3)(ii). Defendant points out that that regulation dealt with the prior exemption of churches from the tax on unrelated business income, and was repealed with respect to years after 1969. Under present law, a church is simply a particular kind of Section 501(c)(3 organization as to which certain benefits are accorded by the tax laws. Before it can be determined that plaintiff is a

church, it must first be determined that it is exempt under Section 501(c)(3).

Defendant is correct in its analysis of the application of the IRC in this case. Whether one is a church or not, as defined by the Code, is not conclusive in determining an organization's tax exempt status under Section 501(c)(3). To obtain exempt status, an organization must show that it is organized and operated exclusively for exempt purposes. Any trade or business operated by the organization must be in furtherance of the organization's exempt purpose. 26 C.F.R. § 1.501(c)(3)-1(e)(1). To be considered an exempt organization under Section 501(c)(3) plaintiff must show it was a church in order to meet the requirement that it is an organization for religious purposes,

but it also must show that it was operated exclusively for those religious purposes and that no net earnings inured to its members.

Plaintiff's compliance with the organizational requirements of the IRC and IRS regulations are not in dispute. 26 C.F.R. § 1.501(c)(3)-1(b)(1). Plaintiff, however, does not satisfy the operational test in the regulations. 26 C.F.R. § 1.501(c)(3)-1(c)(1) and (2). The facts show that plaintiff's direct mail marketing operations in 1977 constituted a nonexempt purpose. Some of the publications and materials produced by plaintiff during the period 1967-77 clearly were associated with, and incidental to, its communication apostolate. The mail order program in 1977, however, involved more than the communication apostolate and it was

an activity which primarily was designed to generate commercial income.

Plaintiff's mail order sales of tax books, golf lessons, and exercising devices constituted an activity engaged in for profit. It is an activity that is a nonexempt function. Plaintiff's evidence indicates that this mail order business was the organization's primary source of operational income.

Plaintiff argues that, because its priests devoted only approximately 10 percent of their working time to direct mail activities, the program was an insubstantial activity that was merely incidental to its sacerdotal and charitable functions. This contention is not persuasive. The circumstance that plaintiff subcontracted the major share of the

work involved in the direct mail operation does not lessen the substantiality and significance of the program. In any event, 10 percent of the priests' activities is not insubstantial. The direct mail activity clearly was a substantial function of plaintiff in 1977. In relation to the other activities of the priests, the direct mail business was not merely incidental.

An organization is not operated exclusively for exempt purposes, unless it serves a public rather than a private interest. Plaintiff was required to establish that it was not operated in 1977 primarily for the benefit of the member priests and their families. 26 C.F.R. § 1.501(c)(3)-1(d)(1)(ii); Basic Bible Church v. Commissioner, 74 T.C. 846, 856 (1980), aff'd, 739 F.2d 266 (7th Cir. 1984); Church of the

Transfiguring Spirit, Inc. v. Commissioner, 76 T.C. 1, 5 (1981). An organization which has as one of its principal purposes the provision of services of benefit to its members is not exempt. Baltimore Regional Joint Board Health and Welfare Fund v. Commissioner, 69 T.C. 554, 557 (1978). Virtually all of plaintiff's 1977 income from the mail order program went for operational expenses. Few expenditures were made which were not either part of the mail order program or for support of plaintiff's members. This support of the priests and their families manifests a nonexempt purpose.

If inurement is present, it results per se in disqualification from exempt status. The Court of Claims held, no matter how minor and insubstantial, the fact of inurement is dispositive. Founding Church of

Scientology v. United States, 412 F.2d 1197, 1200 (Ct. Cl. 1969).

Control over, and supervision of plaintiff's expenditures rested solely with those who benefitted from them. Virtually all plaintiff's income went to the support of its members, and the income was generated by the mail order business established, supervised and controlled by the member priests. On the facts, this is not a situation that involves payment of a reasonable compensation for services by an organization operating for a public interest. Plaintiff's expenditures, which were not fully explained, constituted an inurement to the benefit of private individuals that precludes exemption from Federal income tax.

CONCLUSION

Plaintiff has failed to prove

that in 1977 it was operated exclusively for exempt purposes and that there was no inurement so as to qualify for exemption under Section 501(c)(3). The IRS revocation of plaintiff's exempt status, on the facts, accords with the requirements of the IRC and the IRS regulations. The Clerk is directed to dismiss the complaint. No costs.

Kenneth R. Harkins, Senior Judge

APPENDIX D

PRIVATE RULING 7838028

"This document may not be used or cited as precedent. Section 6110(J)(3) of the Internal Revenue Code."

SECTION 0513

Unrelated v. Not Unrelated Trade or Business

PRIVATE RULING 7838028

DATE: June 21, 1978

REFER REPLY TO: E:EO:T:R:1:3

Dear M:

This is in reply to the letters of February 2, 1977, submitted on your behalf by your authorized representative, in which you request several rulings relating to certain businesses operated by you. Specifically, you request rulings that:

1. The business activities, listed below, carried on by you are

"substantially related" to the exercise of your exempt functions within the meaning of section 513(a) of the Internal Revenue Code of 1954, because they are carried on pursuant to Y's belief that manual labor and self-support are necessary parts of religious life.

2. Your business activities fall within the contributed services exception of section 513(a)(1) of the Code since the individuals working in the businesses receive no direct compensation for their work.

3. For business activities held to be unrelated to your exempt functions, a deduction is allowable under section 162 of the Code for either the fair market value of the labor performed by the monks or the cost of the maintenance of the monks.

4. The Commissioner or his delegate exercise the discretionary authority under section 7805(b) of the Code to provide that any adverse rulings have only prospective application.

The information submitted discloses that you are a monastery of the monastic order of Y. Y is an approved monastic order of the Z Church and maintains houses throughout the world. Y has enjoyed an uninterrupted existence since its founding in the eleventh century.

Manual labor is an important element of the beliefs of Y and plays a significant role in the lives of the monks and nuns. Y follows a rule under which monastic life is divided into three parts (worship, work, and private prayer or reading) that balance one another in such a way as to gather all the physical

and mental activities of the monks and nuns into a harmonious unity. Each of these three parts is essential to the way of life of Y and the daily lives of the Y monks and nuns generally include four to six hours of manual labor.

Labor serves a second function in the way of life of Y. The monastic ideal of "poverty" embraces a frugal and austere life, but not a dependence upon the contributions of outsiders. To this end each monastery strives to be a self-sustaining economic unit. To some extent, the labor of the monks is directed to producing food and other goods that are used directly in the monastery. However, no monastery can produce all of the goods that it needs; part of the labor is devoted to various businesses that produce income to buy

needed goods.

You engage in the following business activities:

1. Agricultural products: grapes, peaches, and timber

2. Processed foods: jelly

3. Concrete blocks.

You have conducted all of your business activities since before May 27, 1969.

These business activities are operated in a manner that is compatible with the religious life and obligations of Y. They are designed to produce a minimum of conflict with the required periods of worship and private prayer. Although the businesses are designed to produce income, economic considerations must at times yield to the religious duties of the monks. You do not expand

your businesses to achieve maximum economic efficiency, but limit them to a size that will yield the amount of income needed to run the monastery.

Substantially all of the work of carrying on your business activities is performed by the monks. All of the monks are expected to work to the extent of their ability, either in the businesses or in the various tasks necessary to monastery life.

The monks are not compensated directly for work in the monastery businesses. The monks are under a vow of poverty and forsake all worldly goods upon joining the monastery. If a monk leaves the monastery, he is not entitled to any part of the property of the monastery. As long as a monk remains in the monastery, however, he will receive

food, shelter, clothing and medical care for life.

Prior to the Tax Reform Act of 1969, churches and conventions or associations of churches were specifically excluded from liability for unrelated business income tax by section 511(a)(2) of the Code. Section 121(a)(1) of the Tax Reform Act of 1969 deleted this exclusion from the statute, thus subjecting churches and conventions or associations of churches to tax for years beginning after December 31, 1969. Temporary relief for existing business activities was provided by section 512(b)(14) of the Code which excludes from tax the income derived by churches and conventions or associations of churches from business activities carried on before May 27, 1969. For taxable years beginning after

December 31, 1975, however, all unrelated business taxable income of churches and conventions or associations of churches is subject to tax.

For years in which the tax is applicable, churches and conventions or associations of churches are subject to the same rules as other exempt organizations that pay unrelated business income tax. Section 1.513-1(a) of the Income Tax Regulations provides generally that income will be subject to tax if 1) it is income from a trade or business; (2) the trade or business is regularly carried on; and (3) the conduct of the trade or business is not related to the organization's performance of its exempt functions.

Your ruling request concedes that the first two requirements of section 1.513-

1(a) of the regulations are present. Your request concerns whether your business activities are related to your exempt functions.

The concept of business activity being "substantially related" to an organization's performance of its exempt function is explained in section 1.513-1(d) of the regulations as follows:

(1) Substantially related - (1) In general. Gross income derives from "unrelated trade or business," within the meaning of section 513(a) if the conduct of the trade or business which produces the income is not substantially related (other than through the production of funds) to the purposes for which exemption is granted. The presence of this requirement necessitates an examination of the relationship between

the business activities which generate the particular income in question - the activities, that is, of producing or distributing the goods or performing the services involved - and the accomplishment of the organization's exempt purposes.

(2) Type of relationship required. Trade or business is "related" to exempt purposes, in the relevant sense, only where the conduct of the business activities has a causal relationship to the achievement of exempt purposes (other than through the production of income); and it is "substantially related," for purposes of section 513, only if the causal relationship is a substantial one. Thus, for the conduct of trade or business from which a particular amount of gross income is derived to be

substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes. Where the production or distribution of the goods or the performance of the service does not contribute importantly to the accomplishment of the exempt purposes of an organization, the income from the sale of the goods or the performance of the service does not derive from the conduct of related trade or business. Whether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and

circumstances involved.

(3) Size and extent of activities. In determining whether activities contribute importantly to the accomplishment of an exempt purpose, the size and extent of the activities involved must be considered in relation to the nature and extent of the exempt function which they purport to serve. Thus, where income is realized by an exempt organization from activities which are in part related to the performance of its exempt functions, but which are conducted on a larger scale than is reasonably necessary for performance of such functions, the gross income attributable to that portion of the activities in excess of the needs of exempt functions constitute gross income from the conduct of unrelated trade or

business. Such income is not derived from the production or distribution of goods or the performance of services which contribute importantly to the accomplishment of any exempt purpose of the organization.

Section 513(a)(1) of the Code provides that the term "unrelated trade or business" does not include any trade or business "in which substantially all the work in carrying on such trade or business is performed for the organization without compensation."

Section 512(a) of the Code provides that the term "unrelated business taxable income" means the gross income derived from unrelated trade or business regularly carried on, less the deductions directly connected with such trade or business.

Section 1.512(a)-1(b) of the regulations provides that in order to qualify as allowable deductions under Section 512(a) of the Code, the deductions must qualify as income tax deductions under Chapter 1 of the Code and be directly connected with the carrying on of unrelated trade or business.

Section 162 of the Code provides that there is allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 7805(b) of the Code provides that the Secretary may prescribe the extent, if any, to which any ruling or regulations, relating to the Internal Revenue laws, shall be applied without retroactive effect.

Applying the law to the facts submitted, we rule on your requests as follows:

(1) The production and sale of agricultural products and processed food products and the manufacture and sale of concrete blocks are not substantially related to your exempt functions other than your need for the income derived from them. Therefore, each of these activities constitutes an unrelated trade or business within the meaning of section 513(a) of the Code.

The production and sale of nonreligious goods is unrelated to your exempt functions because section 1.513-1(d)(2) of the regulations requires that the conduct of a business activity bear a "causal" relationship to the achievement of an organization's exempt

purposes. The causal relationship is not established by the fact that the Y way of life requires monks to engage in manual labor. Each specific business activity must be related to the organization's exempt function. You have not claimed that your business activities are uniquely suited to the performance of your religious functions. Although you undertake business activities only when they are compatible with the religious duties of the monks, the regulations require more than compatibility with exempt functions. The causal relatedness is not established when almost any type of business activity requiring manual labor would be equally useful to you in performing your exempt functions.

Your ruling request admits that one purpose of the business activities is to

produce the income needed to run your monastery. You are, to the extent possible, economically self-sustaining. One criterion you employ in selecting a business activity is the probability that the activity will produce income. The only causal relationship between your non-religious business activities and your exempt functions is that the business activities produce income that is used in the performance of your exempt functions. Section 513(a) of the Code provides that the business activity must be substantially related aside from the need of the organization for income or funds or the use it makes of the profits derived.

(2) Your business activities do not fall within the contributed services exception of section 513(a)(1) of the

Code. Although the monks receive no salary or other direct compensation for their services, they are provided with food, shelter, clothing, and the other necessities of life. It is true that support of the monks is an exempt function of the monastery and that there is no relationship between the amount of work done by a monk and the amount of support received. However, it is the collective effort of the monastery residents that makes their support possible. This is especially clear since you are a self-sustaining economic unit. Although there is no direct compensation, the work is not performed "without compensation" within the meaning of section 513(a)(1).

(3) You are entitled to a deduction for those expenditures (relating to the

cost of the maintenance of the monks) that are incurred incident to the production of your unrelated business income.

(4) Under authority of section 7805(b) of the Code, the Assistant Commissioner (Employee Plans and Exempt Organizations) has determined that this ruling shall be effective for tax years beginning after December 31, 1977.

We are informing your Key District Director of this ruling. You should keep a copy in your permanent records.

Sincerely yours,

(Signed) J. A. Tedesco

J. A. Tedesco
Director, Exempt Organizations Division

Supreme Court, U.S.
FILED
NOV 15 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. 88-446

In the Supreme Court of the United States

OCTOBER TERM, 1988

CONTEMPORARY MISSION, INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

CHARLES FRIED
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

TABLE OF AUTHORITIES

Page

Cases:

Berenyi v. *Immigration Director*, 385 U.S 630 (1967) 8
Bubbling Well Church of Universal Love, Inc. v. *Commissioner*, 670 F.2d 104 (9th Cir. 1981) 6
Church By Mail, Inc. v. *Commissioner*, 765 F.2d 1387 (9th Cir. 1985) 6
Dixon v. *United States*, 381 U.S. 68 (1965) 9
Scripture Press Found. v. *United States*, 285 F.2d 800 (Ct. Cl. 1961), cert. denied, 368 U.S. 985 (1962) 6
Founding Church of Scientology v. *United States*, 412 F.2d 1197 (Ct. Cl. 1969), cert. denied, 397 U.S. 1009 (1970) 9
Trinidad v. *Sagrada Orden*, 263 U.S. 578 (1924) 7, 8

Constitution and statute:

U.S. Const. Amend. I:
Establishment Clause 8
Free Exercise Clause 8

Internal Revenue Code of 1954 (26 U.S.C.):
§ 501(c)(3) 1, 4, 5, 6
§ 7428 5

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

Petitioner contends that the courts below erred in finding that it did not satisfy the statutory qualifications for tax exemption under Section 501(c)(3) of the Internal Revenue Code of 1954.[1]

1. Petitioner is an organization comprising a small group of Catholic priests whose avowed purpose is to promote a "communications and self-improvement apostolate." Petitioner has five members. They met in 1967 while studying at the Montfort Fathers seminary in St. Louis and did inner-city work together there in the late 1960's. As a result of differences with the Montfort Fathers, the group broke away in the early 1970's and moved east to Westport, Connecticut. Petitioner purchased a 19-room mansion with a swimming pool on two acres of waterfront property overlooking Long Island Sound. All of the group resided there, as well as the wife and children of one

[1] Unless otherwise noted, all statutory references are to the Internal Revenue Code of 1954 (26 U.S.C.), as amended (the Code).

member.[2] Pet. App. 5a-11a; C.A. App. A939, A942.

Petitioner did not solicit donations and received few, if any.[3] Instead, petitioner sold products through the mail, an activity which it claimed promoted its "communications and self-improvement apostolate." During the late 1960's and early 1970's, petitioner sold record albums and pamphlets claimed to be of a spiritual self-improvement nature which its members recorded or wrote. By 1977 however, petitioner no longer sold those items. Instead, petitioner sold tax guides guaranteed to save taxpayers a minimum of $500, diet books, weight-reducing bath salts, exercise devices, jewelry with "mood stones," books on golf, and a book containing Edgar Cayce's secrets to youth, beauty and health. None of these items was produced by petitioner. Instead, it purchased the right to market them from outside sources. Pet. App. 8a-18a.

In 1977, petitioner grossed more than $1,460,000 from sales of these items, with sales of the Edgar Cayce book and the tax guides each exceeding $400,000.[4] In that year

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[2] Although it was stipulated that each member was ordained in the Roman Catholic Church and authorized to administer its sacraments, member O'Reilly married in 1975 and fathered four children (Pet. App. 10a-11a; C.A. App. A556).

[3] O'Reilly testified that his mother gave him money to finance a Mercedes 450 XL. There was no other evidence that petitioner received any donations (C.A. App. A946).

[4] O'Reilly admitted that the tax guides were "not * * * religious book[s] as such" but claimed that they were part of petitioner's "self-improvement apostolate" (C.A. App. A641-A642).

In 1978 and later, Berkery, petitioner's leader, wrote four books which petitioner sold, along with other items, through the mail—*Relaxation Diet Program* (a "diet program based on meditation"), *The Secret* ("a self-fulfillment program which tries to teach a person how to better himself totally"), *Edgar Cayce Guide to Self-Healing* and *Biofeedback Without Machines* (both dealing "with self-

it realized a net profit of more than $250,300 from the mail order operation. Pet. App. 14a, 17a. Its members, as a group, devoted approximately ten percent of their working time to the mail order operation, with O'Reilly working five to six hours a day coordinating the entire enterprise. Although almost every member worked on the operation at one time or another, the petitioner also contracted for independent organizations to do much of the work and paid O'Reilly's wife and other outsiders to assist on jobs performed "in-house." C.A. App. A632, A640.

Petitioner prepared its own solicitation materials and hired printers to print the materials and envelopes. It rented mailing lists from commercial list brokers that targeted likely buyers and directed its promotions to individuals shown on those lists. In 1977, petitioner, using other organizations to do the mailing, sent approximately 12 million solicitations throughout the United States, with the bulk of those (more than 9 million) being for the tax guides. It used fictitious names when advertising, *e.g.*, "C.M., Inc., Tax Research Center" and "Golf Research Center," believing that this would increase its sales, and it test-marketed items to determine how profitable they might be. Pet. App. 14a-18a.

Proceeds from the direct mail operation were deposited in petitioner's checking accounts and, through transfers, drawn upon by its members. In 1977, petitioner spent more than $200,500 of the approximately $250,300 net profits realized from the operation on its members and their families. Petitioner did not pay its members a salary, as such, but provided each member with his every need, as well as many luxuries such as frequent restaurant meals, musical instruments (including a Steinway piano), exercise

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fulfillment"). Berkery viewed these books as part of his "religious communication apostolate" (Pet. App. 9a; C.A. App. A999-A1001).

classes, and seminars at self-improvement schools such as EST and the Option Method Institute. Shelter was provided in the 19-room mansion on Long Island Sound. Transportation was provided by making cars (three Mercedes) and a motorcycle available for use. Petitioner also provided the group with a yacht kept docked outside its house. Under the general supervision of either O'Reilly or Berkery, each member had authority to write checks on petitioner's accounts and each did so, sometimes for thousands of dollars at a time. Although large sums of cash were involved, no records were maintained showing their disposition. At trial, the members were unable to explain the specific purpose for many expenditures and offered incompiete, vague, and sometimes overlapping explanations for them. Pet. App. 18a-23a; C.A. App. A946-A947.

2. In 1970, petitioner sought a determination as to its exempt status under Section 501(c)(3) of the Code, submitting a statement by a vice-rector of the Missionary Society of the Holy Apostles that petitioner was "affiliated" with that Society and that once the association was "finalized," petitioner would be included under the Society's "banner" in the Official Catholic Directory. Based on that statement, the District Director of Internal Revenue issued an advisory letter stating that inasmuch as petitioner was an "integral part" of the operation of the Society, which was itself covered by the group exemption letter held by the U.S. Catholic Conference, petitioner also would qualify for exemption under that group letter. Pet. App. 6a-7a.[5]

Several years later, the District Director examined petitioner's operations and in a letter dated September 11, 1979, revoked his prior advisory letter effective as of

[5] A representative of the Missionary Society later advised the Service that the Society had, in fact, no relationship with petitioner, except a "spiritual association" (Pet. App. 7a).

January 1, 1977. The District Director found that petitioner was not exempt under the group ruling issued to the U.S. Catholic Conference since procedures for "obtaining or maintaining exemption as a subordinate organization affiliated with, and under the general supervision and control of" that Conference, had not been met.[6] He also found that petitioner did not qualify for exemption in its own right, because the evidence showed that it operated with a substantial commercial purpose and not exclusively for tax-exempt purposes as required by Section 501(c)(3). He found that petitioner also failed to show that no part of its net earnings inured to the benefit of private individuals and that it served public rather than private interests. Pet. App. 11a-13a; C.A. App. A50.

Petitioner sought review of the District Director's determination in the Claims Court pursuant to Section 7428 of the Code. After trial, that court sustained the District Director's position (Pet. App. 4a-32a). The court held that as of 1977, petitioner's primary goal in operating its mail order business was to generate commercial income, and that it engaged in that business on a substantial scale, both in an absolute sense and in relation to its other activities (*id.* at 23a-29a). The court also agreed that petitioner failed to show that no part of its net earnings inured to the benefit of private individuals. Petitioner's five members controlled petitioner, dictated when and for what purpose its revenue would be spent, and in fact spent almost all of it on themselves. The potential for abuse present under these circumstances required open and candid disclosure

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[6] Under those procedures, the Conference must "submit annually a list of organizations to be dropped or added to the group ruling," which it accomplishes "by submitting a copy of the Official Catholic Directory." Petitioner, the District Director noted, "does not, and has never, appeared in the Directory." C.A. App. A50.

of the facts and a full explanation of each expenditure made, yet the court pointed out that that had not been provided. It also found that the benefits received were patterned more to the members' individual needs and wants than to any measured contribution to the business, and could not be taken to represent payment of reasonable compensation by an organization operated for a public interest (*id.* at 29a-32a). The court of appeals affirmed, agreeing with the Claims Court that petitioner failed to qualify as a tax-exempt organization both because it was not operated primarily for tax-exempt purposes and because a substantial part of its net earnings inured to the member-priests and their families (*id.* at 1a-3a).

3. a. It is well established that the question whether an organization has a non-exempt purpose that is sufficiently substantial to make it ineligible for a Section 501(c)(3) tax exemption, rather than one that is merely incidental to its operations, is a question of fact. See, *e.g.*, *Church By Mail, Inc.* v. *Commissioner*, 765 F.2d 1387, 1390 (9th Cir. 1985); *Scripture Press Found.* v. *United States*, 285 F.2d 800 (Ct. Cl. 1961), cert. denied, 368 U.S. 985 (1962). Whether any part of an organization's net earnings inures to private persons is also a question of fact. See, *e.g.*, *Bubbling Well Church of Universal Love, Inc.* v. *Commissioner*, 670 F.2d 104 (9th Cir. 1981). The factual conclusions of both courts below that petitioner failed to qualify for a Section 501(c)(3) tax exemption on both of these grounds were amply supported by the record.

In particular, petitioner's sales of items such as tax guides, golf lessons, and exercise devices could hardly be viewed as furthering the communications apostolate that it allegedly sought to promote, and its members admitted as much. Yet in 1977, those non-religious products were virtually all it sold, a fact compelling the inference that its

primary goal in operating the business was the commerical one of making the largest profits possible. By the same token, the finding that petitioner engaged in the business on a substantial scale was supported by the facts showing that its members devoted significant time to the work while also subcontracting out much of it, that they conducted business on a grand scale sending out millions of solicitations and using the marketing techniques of a commercial mail order house, and that they netted over a quarter of a million dollars in profits in 1977 alone. Similarly, the inurement finding was supported by evidence showing that the members spent 80% of those profits on themselves, on items going well beyond mere subsistence.

b. Petitioner mainly argues (Pet. 8-14) that providing its members with subsistence should not be considered inurement and raising funds to pay for that should not destroy its exemption. At bottom, this is nothing more than an attack on the findings of fact below, and one entirely without merit.

To begin with, there is no support for the contention that the members received only subsistence. Petitioner spent more than $200,000 in 1977 alone (more than $40,000 per member) on that "subsistence." Rather than living in a frugal or ascetic fashion consistent with a vow of poverty, they enjoyed every manner of luxury. Petitioner's members exercised complete and unfettered control over petitioner and could use its earnings however they pleased. Thus, their failure to justify the generous benefits which they provided for themselves—and to explain the purpose for many other expenditures made—compelled an inference of impermissible inurement.

There is no basis for petitioner's suggestion (Pet. 8, 12-13) that it is no different from the religious order involved in *Trinidad* v. *Sagrada Orden*, 263 U.S. 578 (1924),

and that the decisions below are in conflict with that case.[7] In *Sagrada Orden* the parties stipulated that no part of the organization's net earnings inured to the benefit of any private individual (*id.* at 579-580). Also, in that case, unlike here, the organization clearly had no substantial non-exempt purpose. Most of its income was from investments, and the small profit made from sales of wine and other articles supplied for use in its churches could not destroy the exemption because the courts there found as a fact that "[f]inancial gain" was "not the end to which [those sales were] directed" (*id.* at 582). Here, to the contrary, the courts found that beginning in 1977, financial gain was the ultimate purpose for petitioner's operation of its mail order business. There is no reason for this Court to depart from its usual practice of declining to review the concurrent findings of fact of two lower courts. See, *e.g.*, *Berenyi* v. *Immigration Director,* 385 U.S. 630, 635-636 (1967).

c. Petitioner argues that denial of its tax exemption violates the Free Exercise and Establishment Clauses of the First Amendment because the courts applied "different and more rigorous" standards in testing its status than those applied to religious orders of the Roman Catholic Church (Pet. 15-17). It claims that although the government's position is that its members "spent too much time and money on their direct mail activity" and "did not adequately substantiate their religious activities," the Internal Revenue Service has approved similar direct mail activity

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[7] Petitioner's assertion (Pet. 10) that it is an "acknowledged religious order" again finds no support in the record. Although petitioner claimed to be a pious society of the Roman Catholic Church, it produced no documents to support that contention, has never been listed in the Official Catholic Directory, and is not included among the organizations covered by the group ruling issued to the U.S. Catholic Conference (Pet. App. 22a-23a).

in several private letter rulings issued to various Roman Catholic orders (*id.* at 15-16).[8] But it is clear that each taxpayer must establish its own qualification for exemption; a taxpayer cannot premise its right to an exemption on an assertion that others have been treated generously, leniently or erroneously by the Internal Revenue Service. See, *e.g., Dixon* v. *United States,* 381 U.S. 68 (1965); *Founding Church of Scientology* v. *United States,* 412 F.2d 1197, 1200 (Ct. Cl. 1969), cert. denied, 397 U.S. 1009 (1970). That the organizations covered by the rulings that petitioner has cited were able to demonstrate that they conduct a sufficiently large array of exempt activities to warrant a finding that the mail order activity of each was only incidental, and not animated by a substantial commercial purpose, is ultimately irrelevant to the question whether petitioner's mail order activities were a substantial part of its operations.

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[8] Petitioner claims (Pet. 17) that the courts below "refused to consider the priests' prayer and worship as part of their exempt activities." That is not correct. The record shows that the members described the nature, existence and performance of the activities that they claimed entitled it to exemption only in the most vague and general terms. Some described anecdotally some of their counseling activities, but they offered no records or other corroboration of such activities (C.A. App. A628-A629, A1014-A1015). In some instances they testified as to what a "typical" day consisted of. For example, Berkery testified that "typically" he would get up, pray and say mass, exercise, eat meals, and then, that he "might" spend some time socializing, meditating, writing, answering his mail, making phone calls, or counseling (C.A. App. A993-A997). In contrast, they testified at length and with specificity about the mail order business and the time and effort devoted to it. On the record, the lower courts certainly were warranted in finding that the mail order business was a substantial part of the overall operation and was animated by a substantial commercial purpose.

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

CHARLES FRIED
Solicitor General

NOVEMBER 1988

☆ U.S. GOVERNMENT PRINTING OFFICE: 1988—241-699/60758

Supreme Court, U.S.
FILED
DEC 1 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. 88-446

IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

CONTEMPORARY MISSION, INC.,
Petitioner,

v.

UNITED STATES OF AMERICA,
Respondent.

REPLY BRIEF

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TABLE OF AUTHORITIES

PAGE

Cases:

Trinidad v. Sagrada Orden, 263 U.S. 578 (1924)..... 2

Miscellaneous:

M. Emory and L. Zelanak, "Tax Exempt Status of Communitarian Religious Organizations", 50 Fordham L. Rev. 1085 (1982)..... 7,8

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Petition and Brief of Petitioner, 1921 O.T. No. 353, Trinidad v. Sagrada Orden..... 3

IN THE SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1988

No. 88-446

CONTEMPORARY MISSION, INC., PETITIONER

V.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE FEDERAL CIRCUIT

PETITIONER'S REPLY BRIEF

The Government's memorandum in opposition represents an attempt to magnify and characterize all the material aspects of Petitioner's activities, totally ignoring the religious activities which Petitioner's members conducted with its money and property. Using such an analysis, few religious orders or

churches could retain exempt status, since it requires substantial funds and property to conduct an effective spiritual ministry.

The Government's memorandum does not even mention that the lower courts found that only 10 percent of the time of Petitioner's members was spent on fundraising (Pet. App. 17a); the rest was devoted to the halfway house, funeral, counseling, and other ministries described in the Petition (pp. 4-6).

The Government erroneously attempts to distinguish this case from Trinidad v. Sagrada Orden, 263 U.S. 578 (1924), on the basis that there the Philippine Dominican Order largely supported itself with rents from its real property holdings, whereas here Petitioner supported itself with proceeds from the

direct-mail sales of books and similar items. This is a distinction without a difference. Managing property to earn rents is not a more "charitable" or "religious" fundraising than direct mail sales. Indeed, the Government's argument confirms the fact that the Dominicans were far wealthier than Petitioner, since they had extensive landholdings which enabled them to live off their rents.[1]

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[1] The Government's brief in this Court in Sagrada Orden described the Dominican Order's activities as involving "the renting and leasing of the houses and large estates * * *." (Emphasis added.) Petition and Brief of Petitioner, 1921 O.T. No. 353, Trinidad v. Sagrada Orden, p. 12. The Dominicans' income in 1913 was described elsewhere in the Government's brief as follows (id. at 9): "Income received from rents of houses and agricultural estates, 91,141.69 pesos; dividends from the Bank of the Philippines and various industrial companies or corportaions, 95,918.04 pesos; profits from other investments and corporations, 54,239.19 pesos; grand total, 241298.92 pesos." Gross income was 254,702.69 pesos, expenses were

Petitioner, by contrast did not own substantial real property, attempted to sell only religious books and tapes in the early 1970's but could not support itself on these, and thus had to sell other items to finance its ministries. This is not unusual for tax-exempt religious orders -- as our Petition explains (p. 16), tax-exempt religious orders typically sell a wide variety of products both by mail and on the open market to support themselves. Nonetheless, they are tax-exempt, because they use their funds to support their religious ministries, as Petitioner did here.

69,745.88 pesos, and net income was 184,956.81 pesos, amounting to a 72.6 percent profit margin. (Id.)

The Government's attempt to mischaracterize Petitioner's material goods is shameful. The so-called "yacht"[2] was actually a motorboat costing $13,650 (A. 255), used to entertain youth from the halfway house. A $250,000 house in Connecticut, serving as Petitioner's headquarters, chapel and offices, and the residence of five clergy, one family, and two orphans, is not a "mansion". Mercedes diesels with over 250,000 miles each, and a motorcycle, used to commute to the Petitioner's ministries in New York City and elsewhere, are functional transportation, not "luxuries". The $40,000 in expenditures per member was not solely for mere personal expenses,

[2] The Government gives no record reference for its "yacht" mischaracterization.

but also included the capital and current expenses of their religious ministry (see Pet. 4).

At bottom, the Government's position here constitutes gross discrimination against Petitioner merely because Petitioner cut some of its ties with the United States Catholic Conference, and was no longer listed in the Official Catholic Directory. Indeed, the Government argues (Memo. 8) that Petitioner is not a "religious order" because it is not listed in the Official Catholic Directory. Actually, a religious order is any group whose members take and live vows of poverty, chastity and obedience, and devote themselves to religious ministries and necessary fundraising. See 26 Encyclopedia Britannica, "Roman

Catholicism", 923 (15th ed.).

There are hundreds of Buddhist, Protestant, Eastern Orthodox, and other groups that satisfy that definition, and should qualify for tax-exempt status, like "official" Roman Catholic religious orders. See 12 New Catholic Encyclopedia, "Religious Orders (Communities), Protestant", 295 (1967); 12 M. Eliade (ed.), The Encyclopedia of Religion, "Religious Communities", 302, 306-307 (1987); M. Emory and L. Zelanak, "The Tax Exempt Status of Communitarian Religious Organizations", 50 Fordham L. Rev. 1085, 1088 (1982). Unfortunately, as so often happens, the courts and the Government have applied a far more rigorous test to the religious order here mainly because it was not listed in the "Official Catholic Directory", in

violation of both Section 501(c)(3) and the First Amendment. See M. Emory and L. Zelanak, supra.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted

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